Ref: CICRA 16/27
Please quote the reference in all correspondence

23 June 2016

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Dear Graeme

Telecommunications Licence - Contravention of Licence Condition 34

1. Following an investigation of whether the pricing of JT in the broadband market in Jersey constituted a margin squeeze, the Jersey Competition Regulatory Authority (the "Authority") communicated its findings in the form of a provisional decision and draft direction to JT (Jersey) Limited ("JT") on 6 November 2015.

2. The communication set out that the JCRA was of the view JT had contravened Licence Condition 34 of its Class III Telecommunications Licence granted by the Authority by effecting a margin squeeze for its JT Broadband Home Product and JT Complete Product[1]. That letter also set out the analysis behind the Authority's conclusions and invited JT to make written representations on the matter. JT, on 7 December 2015, provided its response. Following a request by JT, JT and its advisors (PwC) met with CICRA officers and its advisors (SPC Network) on 15 March 2016 in order to discuss the matters raised by JT and the JCRA's analysis. The Authority's investigation into complaints raised by JT competitors regarding the manner in which the provision of fibre router subsidies is implemented by JT also gave rise to new evidence that the Authority considered relevant.

[1] These two products shall be referred to as "**JT Broadband Home"** and **JT Broadband Complete** in this letter and the accompanying Direction.

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3. Having taken into account JT's responses, the meeting of 15 March 2016 and new evidence, the Authority wrote to JT on 22 April 2016 giving written notification of its new provisional decision that JT contravened Condition 34 of its Class III Telecommunications Licence granted by the Authority. JT was again provided with the complete model underpinning the analysis and responded on 23 May 2016.

4. The Authority has considered the points raised by JT in its responses and remains of the view that JT contravened Condition 34 of its Licence. In the circumstances, the Authority is issuing a direction under Article 19 of the Telecommunications (Jersey) Law 2002 ("**the Telecoms Law**") that JT has contravened Condition 34 of its Licence. It is also setting out the steps JT will need to take to ensure compliance with that Licence Condition. The Direction is provided with this letter as Annex 1.

5. The JCRA notes that JT in its response states that it is being unfairly and inappropriately targeted, that a campaign is being pursued against it by the JCRA and that the JCRA has been unwilling to take any notice of JT's views. These claims are rejected entirely as having no foundation or substance. JT has been given and availed itself of due process in all cases where there has been cause to investigate its behaviour. JT has also accepted that its behaviour has contravened or informally accepted there was a risk of contravening its licence on at least three occasions within the past two years; a high level of contravention by any regulatory standards. This letter demonstrates that JT has been given a full and fair hearing despite the claims in its response. The JCRA therefore categorically does not accept these unfounded allegations made by JT.

6. The JT response of 23 May 2016 states that the requirements of the draft direction are wholly unclear to it. This is not a position that was conveyed previously despite extensive opportunity provided to JT, and in particular the meeting of 15 March 2016. The Direction accompanying this letter therefore seeks to address such concerns.

7. The Authority's assessment of JT's responses is set out in Part A of this letter. Part B discusses the conclusion the JCRA has come to based on the evidence and processes in carrying out this investigation.

PART A

8. JT's response of 7 December 2015 is referred to as the **First Response** and the response of 22 April 2016 as the **Second Response**. JT in its Second Response identifies "*two significant issues with the conclusion reached by the JCRA*".

JT Issue 1 headed - *"the broadband market in Jersey"*

9. In its Second Response JT stated the following regarding one of the products (2 Mbps) included in the margin squeeze assessment:

> *"The principle reason for this promotion was to mitigate the rising costs for customers who had previously purchased a lower bandwidth product and who were therefore involuntarily receiving a better product, but also, eventually, being charged a higher*

price. In this regard, it is important to note (and the JCRA seemingly had not) that the promotion was available only to existing[2] JT customers affected by the change in pricing. New customers could not take advantage of the offer so there was never any prospect of JT's competitors' customers or new customers to the market choosing to migrate to JT as result of and in reliance on the offer, it was simply not available to them."

10. JT also stated that: "*the promotion was intended to smooth the transition for customers, and that is precisely what it has done*".

11. It should be made clear that a margin squeeze was found whether the 'promotion' price or the subsequent price for this one (2 Mbps) product was included in the model over the period assessed. JT's response suggests that the margin squeeze finding is limited to the retail price promotion for the 2 Mbps product. The scope of products assessed is wider than this single product and a margin squeeze was found with and without the promotion. While the promotion applied by JT for the 2 Mbps product did not cause the margin squeeze it did have the effect of worsening the extent of the margin squeeze finding.

12. The issue of margin squeeze under investigation is essentially whether the retail subscription prices for relevant broadband telecommunication services offered by JT in Jersey, when set against reasonably efficient costs of providing broadband as a retailer in Jersey, led to a situation that was loss-making for such a broadband retailer. The fact that the promotion price for a product makes up the subscription price over the period of the assessment suggests it is reasonable for it to be taken into account.

13. There also appears to be some suggestion in these comments by JT that tying its existing customers into a further contract term should not have any relevance to competition because they are existing JT customers. Competition for customers with or without a contract with a competitor may present different challenges for a competitor but that does not imply competition for them cannot take place. Customers can voluntarily end contracts before their term is up and bear the exit costs of early termination where they consider competitive alternatives are worth switching to. Competitors may also meet such exit costs on behalf of customers where the value of that customer to them is worthwhile. Competitors still need to price at levels to compete for customers of competitors whether in contract or not and JT's prices to those customers are therefore relevant to a margin squeeze assessment.

JT Issue 2 headed - '*over the period June 2014 to December 2015*".

14. JT considers that the promotion was "available for such a short time to such a small subset of broadband customers (existing customers)" that the JCRA's investigation was therefore not warranted. The Second Response states that there must therefore be significant doubt whether any such offer could ever have any real impact on the wider broadband market.

[2] emphasis provided by JT

15. Promotion offers were only available to JT customers to sign up to between "May/June and July 2014" and after 28 July 2014 any promotion prices were no longer available (to anyone). The effect on the market was that [✂] customers[3] were signed up to an 18 month contract that alternative competing operators would have greater difficulty to compete away from JT (1) because of the customer being tied to JT, and (2) that the resulting margin squeeze was impacting on JT's retail competitors ability to compete with JT's market pricing.

16. The total number of customers taking up the offer was significant in the context of the Jersey broadband market, comparable to the total broadband customer base of each of JT's competitors. The suggestion that only a small proportion of the market was affected by a 'promotion' based on the number and proportion of customers of JT taking one of the products in the scope of the assessment in any event does not address the wider point that the scope of the assessment extended beyond a single product and a single promotion.

JCRA Notification Process

17. JT states in its Second Response that:

> *"Finally, and significantly, this promotion was notified by JT to the JCRA through the usual notification process before it was run. No objection was raised by the JCRA or competitor at the time in response to what was a public notice."*

18. JT did not raise this point in its First Response. The obligation contained in Licence Condition 33.1 of JT's licence is for JT "to publish […] at least 21 days price to their coming into effect". The JCRA does not have a duty or obligation to approve any notification before the prices come into effect and the absence of making a decision before the pricing changes came into effect cannot be construed by JT as approval of such changes or preclude the JCRA from investigating after they have come into effect.

19. Licence Condition 33.4 does include the following provision:

> *"If the JCRA, after consulting the Licensee and such other persons as it may determine, is satisfied that any published price, discount scheme or special offer is in breach the Telecommunications (Jersey) Law or this Licence, the JCRA may, by issuing a direction, require the Licensee to bring the relevant prices, discount schemes or special offers into conformity with the Laws and/or the requirements of this Licence."*

20. A media release was issued by the JCRA on 21 May 2014 announcing it was investigating a series of practices by JT that presented risks to competition in the broadband market with negative consequences for customers in the long term through reducing choice and value for money in telecom services. JT and other operators made media statements following this. In particular JT's public statement said "*Firstly, JT is proposing the most radical shake-up of broadband in Jersey for a*

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[3] [✂] customers took up the offer and signed up for the 18 month 2 Mbps product contract.

decade, so it's no surprise at all that the regulator wants to take a closer look at that." JT also received a letter dated 18 June informing it of JCRA concerns together with an information request to commence the investigation.

21. JT suggesting no concerns were raised by the JCRA when this product was notified is not consistent with the facts, and given what JT acknowledge was a significant change to broadband in Jersey it would not have been realistic to expect that the JCRA could have completed an assessment within the 21 day period of notification provided for under Licence Condition 33.

Effect on market share of JT's competitors

22. JT states that during the promotion period competitors increased their market shares suggesting this was evidence of the absence of any margin squeeze that harmed competition.

23. This point was addressed by the JCRA in its letter to JT of 22 April 2016 (page 2).

> ***"A competitor increasing market share does not preclude the existence of a margin squeeze. It is neither a sufficient nor necessary condition that competitor market shares should remain the same or decline when a dominant firm is engaged in margin squeeze. The fact that JT's competitors were aware of the Authority's investigation may well have been a factor taken into account in sustaining their competitive challenge in the broadband market in the expectation that market conditions would change as an outcome of an Authority decision to remove the competitive harm they faced. It is also the case that JT competitor market shares may well have increased even further in the absence of margin squeeze. The suggestion that competitor growth in market share implies the absence of competitive harm is not one which is accepted."***

USE OF THE REASONABLY EFFICIENT OPERATOR ("REO") APPROACH

24. JT in its Second Response repeats its objection to the REO approach as the basis for the assessment. An assertion made in that response is that "*It is common ground that this margin squeeze decision has been made pursuant to the JCRA's ex-post competition powers…*".

25. This position is not consistent with what was conveyed to JT in the JCRA letter of 22 April 2016 which explains that the investigation relates to a contravention of a condition of its licence issued under the Telecommunications (Jersey) Law 2002.

26. JT's specific arguments in its Second Response that its Licence Condition 34 must follow competition law principles and that duties on the JCRA under the Telecoms Law 2002 are not therefore relevant to the assessment of margin squeeze in this case are addressed under a separate heading.

27. JT cites Ofcom's decision in 2013 to close its investigation of BT's pricing of its Wholesale Calls product in support of its argument that an ex-post analysis also ought necessarily to focus on effect. The conclusions of the ERG report are also considered by JT to be informative in this regard.

The context of the Ofcom and ERG reference are in respect of the application of competition law powers. Since the JCRA is not applying its competition law powers but its powers and duties under the Telecoms Law, the facts of the Ofcom case and above ERG reference in support of the JT position are not considered applicable to the margin squeeze assessment and approach by the JCRA in this case.

28. Where the ERG report supports the REO approach and cited by JT, JT suggest that the conditions for that approach are not valid in the Jersey market. The ERG report is quoted as, "*The test to be used is very dependent on the specific circumstances of the case and the objective of the NRA. For example, if the market is mature and the main aim is to promote competition then there might be merit in using the REO test*."

29. JT cites but does not reference a JCRA stated view that the Jersey market is not mature and on this basis seeks to dismiss the use of the REO test and the above view by ERG. However, given the high level of take-up of broadband in what is one of the world's wealthiest economies on a per capita basis, it is the case that the fixed broadband market in Jersey is mature in the sense of take-up. It is not mature in terms of the development of competition. It appears JT has taken a particular interpretation of the concept that was not intended.

30. To cover this important aspect of JT's objection to the JCRA's finding the rationale is expanded on below together with previous responses to JT on this aspect.

31. In its Recommendation on the regulation of Next Generation Access (NGA), the European Commission wrote:

> *"In the specific context of ex ante price controls aiming to maintain effective competition between operators not benefiting from the same economies of scale and scope and having different unit network costs, a "reasonably efficient operator test" would normally be appropriate."*[4]

32. Unlike competition authorities, sectoral regulators such as the JCRA have a statutory duty to promote competition in the market that it regulates. It is informative to note that in setting the ex ante margin for BT's wholesale broadband access product, Ofcom described this difference as follows:

> *"… in terms of a margin squeeze analysis ex post competition law would tend to start from a presumption that the appropriate standard against which the dominant firm should be assessed is one of equally efficient competitors i.e. analysing the margin such that an equally (or more) efficient competitor to BT could enter and compete effectively with BT in the relevant downstream services markets.* ***However, … the context for the setting of a margin for [wholesale broadband access] is one of ex ante regulation which has as its objective the promotion of competition****. Given this objective, Ofcom has concluded that a modification of this concept is warranted."*[5]

[4] European Commission (2010) *'Commission Recommendations of 20th September 2010 on regulated access to Next Generation Access Networks'* SEC (2010) 1037

[5] Ofcom (2004), 'Direction Setting the Margin between IPStream and ATM Interconnection Prices', August 26, para 2.4, p. 15 [Emphasis added]

33. In conducting the margin squeeze test, the JCRA has taken the view that entrants in the broadband market in Jersey could not be expected to enjoy the same advantages as the incumbent and that therefore a REO standard should be used to ensure that sufficient margin is available for new entrants. The entrants' disadvantages in the provision of retail broadband in Jersey come from three sources:

a. economies of scale and scope;

b. data volumes, and

c. average customer lifetime.

34. In carrying out its margin squeeze investigation SPC adjusted the margin squeeze test to account for these disadvantages. The JCRA's reasoning for the approach taken was formally explained to JT in the letters of 6 November 2015 (paragraphs 3.4-3.7) and 22 April 2016 (pages 2-3).

<u>JCRA 6 November 2015</u>

"3.4 A key aspect of the analysis of margin squeeze cases is whether the competitor should be as efficient as the dominant firm (Equally Efficient Operator – EED) or reasonably efficient (Reasonably Efficient Operator – REO).

3.5 The assumption used as standard in competition law is that a competitor should be equally as efficient as the dominant firm. However, in a market such as Jersey which is subject to ex ante regulation and where competition is still being introduced, there is an argument that the entrant could not be as efficient as the incumbent. The entrant would not have the economies of scale and scope of the incumbent and there are additional costs of entry that an incumbent does not have to meet given it is vertically integrated and provides the key inputs (wholesale broadband) to its retail customers.

3.6 Further support for the use of the REO standard can be found in the Recommendation on the Regulation of Next Generation Access (NGA) where the European Commission wrote:
"in the specific context of ex ante price controls aiming to maintain effective competition between operators not benefitting from the same economies of scale and scope and having different unit network costs, a 'reasonably efficient operator test' will normally be more appropriate."[6]

3.7 In conducting the margin squeeze test, SPC took the view that entrants in the broadband market in Jersey could not be expected to enjoy the same advantages as the incumbent and that a REO standard should therefore be used to ensure that sufficient margin is available for new entrants. The Authority agrees with this conclusion. SPC was of the view that entrants' disadvantages come from three sources: economies of scale and scope, data volumes and average customer lifetime. SPC's margin squeeze test was adjusted to take account of these disadvantages:

- ***Economies of Scale and Scope – at present JT enjoys a market share of around 80% and the economies of scale and scope that accompany such a large share. An entrant could not have the same market share as JT enjoys today given the household penetration of broadband in Jersey. In this***

[6] European Commission (2010) 'Commission Recommendation of 20th September on regulated access to Next Generation Access Networks' SEC (2010) 1037

regard, it is of note that JT's two competitors, Newtel and Sure, each have just over 10% of the market share.[7] In developing the market squeeze test, it is considered appropriate to set the market share at 10%, i.e., at the approximate share of entrants.

- ***Entrant Specific Costs – these are costs that entrants incur but incumbents do not. SPC identified three entrant specific costs in Jersey: the joining link between the entrant and the incumbent, monthly usage and average customer lifetime. The joining link between the entrant and the incumbent is incorporated into SPC's model as a direct cost dependent on the necessary throughput. The remaining two are more indirect costs and are considered below.***
- ***Monthly usage – According to data provided by JT, its average user transmits and receives [✂]GB per month. However, JT charges consumers who exceed the monthly transmission allowance at a rate of 30p per GB (referred to as overage charges). In comparison, the price plans of JT's competitors only offer unlimited access. It is possible that consumers with high average monthly usage may well be the first to switch to unlimited offers from JT's competitors to take advantage of lower prices. Residents of Jersey have access to the same content as residents in the UK and in particular to data intensive content such as BBC i-player, ITV-Player and Netflix. In the UK the average monthly usage is 58GB per month.[8] An average monthly usage of 58GB is also supported by direct evidence from the Jersey market. Additional data usage requires additional on-island and off-island backhaul capacity that has to be paid for from the retail charge. Whereas JT is able to raise additional revenue at the retail level to pay for this backhaul, their competitors are not considered to be in a strong a position as JT to make such charges, given customers require an incentive to switch to JT's competitors on the basis of more compelling offers, including through lower pricing. The two entrants therefore bear the cost of providing unlimited monthly usage whereas JT does not. Accordingly, SPC considers that this cost should be addressed in the margin squeeze test. Further, in developing the margin squeeze test, it is considered appropriate to set the average monthly usage at 58GB (being the average rate applied in the UK).***
- ***Average customer lifetimes ("ACL") (indirect cost) – The EC in its Recommendation states: "The relevant period for this ex ante economic replicability test should be set in accordance with the estimated average customer lifetime".[9] There is evidence that entrants have a shorter ACL than incumbents and so must adjust their pricing to amortise customer acquisition costs over a shorter ACL. For example, in setting the VULA margin squeeze test Ofcom concluded that "there is a material difference in the ACL between BT and other CPs" (para 6.454) and "that, on balance, this would appear likely to be an advantage of BT that other operators cannot match" (para 6.455). Finally, it concluded, "other operators are likely to have a materially shorter ACL than BT" (para 6.458).***

As to what is an appropriate level to set the ACL, this was discussed at length in Telefonica (paragraphs 475 – 489). Here, the European Commission concluded that an ACL of 3 years was appropriate but accepted that this period favoured

[7] CICRA (2013) 'Telecommunications Statistics Market Report', September 2015

[8] Ofcom (2014) 'Infrastructure Report' p13

[9] European Commission (2013) 'Recommendation on consistent non-discrimination obligations and costing methodologies to promote competition and enhance the broadband investment environment' Annex II(v)

Telefonica because its business plan assumed an ACL of 2 years for the purposes of amortising customer acquisition costs (para 489). A 2 year ACL is also supported by direct evidence from the Jersey market. Having considered the evidence it is deemed that an ACL of 2 years is most appropriate in developing the margin squeeze test."

JCRA 22 April 2016 letter

"JT in its letter of 7 December stated that it considered that the Authority's and SPC's use of the Reasonably Efficient Operator (REO) approach is contrary to the Equally Efficient Operator (EEO) approach that is followed by Competition Authorities in ex-post margin squeeze assessments in the telecoms sector[10].
In the Authority's view a REO model is considered appropriate given the circumstances of this investigation. In particular:

The economies of scale that JT enjoyed at the time of the complaint and continues to enjoy are significant relative to its competitors. Only one firm can have 80% market share and so using sales volumes based on this market share to carry out a margin squeeze test is not consistent with the duty to promote competition,
There are entrant specific costs which the incumbent does not incur (such as backhaul and a shorter cost recovery period given a shorter Average Customer Lifespan (ACL)) that has an effect on the entrant's costs but not JT's costs. For such costs not to be taken into account would also be contrary to a duty to promote competition.
The use of the EEO approach as proposed by JT would therefore not be consistent with the duty to promote competition. Decisions by the European Commission comment on matters pertinent to this assessment[11]. In addition both Ofcom[12] and ComReg[13] (in ex ante regulatory decisions)[14,15] have used adjusted EEO models when assessing the dominant operator.
Ofcom in its Pay TV Statement[16] commented on the difficulties of an entrant achieving the scale of the incumbent owing to the penetration of the dominant operator.
JT has further argued that the EEO test is the logical test to use for an ex post investigation as when JT sets prices it is only aware of its own costs and has no way to take into account other operators' costs to test whether JT is acting in an anti-competitive manner. This has been taken into account by the Authority when considering appropriate remedies having found a contravention. However, as a dominant firm, JT has a responsibility not to abuse that position and so must take into account in its pricing decisions the potential impact on its competitors, who are also its wholesale customers. Through engagement with these customers JT should have been aware of the consequences of its wholesale pricing and the

[10] JT supplied references to COMP/38.784, 4 July 2007, Wanadoo España vs. Telefónica and Case C-280/08 P, 14 October 2010, Deutsche Telekom AG v Commission.

[11] The European Commission noted in its decision on the *Telefonica* margin squeeze case that the EEO test favoured Telefonica, as given the economies of scale and scope it enjoyed, "its unit costs can be expected to be lower than those of its reasonably efficient rivals". The Commission recognised that a reasonably efficient competitor, which shared the same cost structure as Telefonica but which did not have the same economies of scale, would inevitably have higher unit costs.

[12] Ofcom (2013) *'Fixed access market reviews: wholesale local access, wholesale fixed analogue exchange lines, ISDN2 and ISDN30: Consultation on proposed markets, market power determination and remedies'* 3 July 2013. (Paragraphs 11.247 – 11.429)

[13] ComReg (2013) *'Next Generation Access: Remedies for Next Generation Access Markets'* 31/01/2013

[14] Ofcom recognised that an entrant will not have the same scale advantages as the incumbent. It its Virtual Unbundled Local Access (VULA) margin squeeze test, Ofcom deploys what it calls an Adjusted EEO model where, *inter alia*, the scale of the benchmark operator is adjusted to reflect the retail market share of BT's main competitors …. This market share allows the benchmark operator to benefit from some economics of scale but not at the same level at BT.

[15] ComReg applies what it calls a Similarly Efficient Operator (SEO) test, and again assumes a market share of around 25%

[16] Ofcom (2010) *'Pay TV Statement''*31/03/2010. *"*The rate-card prices are close to what we would expect under an ex post margin squeeze test – i.e. assuming Sky's own scale. No entrant would have Sky's scale, nor would we expect one to be able to reach Sky's scale, given Sky's current subscriber numbers relative to the likely number of total pay TV households in the UK."

impact of the pricing changes on competition. JT's view that it had no means of being aware there were no concerns about its broadband pricing is not accepted".

35. The approach by the JCRA is contingent on the context of competition that exists in the market and its duties under the relevant law. The JCRA has discretion to choose the methodological approach that it considers is best calculated to fulfil its Article 7 duties under the Telecoms Law. The Telecoms Law gives the JCRA such discretion precisely because the nature and challenges in meeting its duties will differ across the telecoms sector. In the provision of broadband in Jersey JT has a dominant position and sustained that position beyond a decade following opening of the market to competition. Competitors have for an extended period of time argued that JT's pricing is harming competition. In other areas of the telecoms sector such as retail mobile services or provision of wholesale off-island leased lines JT does not have a dominant position. The JCRA therefore cannot be limited to only one methodological approach across different competitive conditions and the application of the same methodology to different competition issues and context would be inappropriate.

36. It is the case that competition law case precedent suggests the EEO approach as the generally accepted methodology. However, the JCRA is not acting under the powers of the Competition (Jersey) Law 2005 but the Telecoms Law which gives it the discretion to perform its functions under this Telecoms Law in such manner as it considers is best calculated to protect and further the short-term and long-term interests of users within Jersey of telecommunications services and apparatus, and perform them, wherever it considers it appropriate, by promoting competition among persons engaged in commercial activities connected with telecommunications in Jersey.

37. It is also relevant to highlight the Jersey Royal Court in its judgment:

Paragraph 123, [2013] JRC238

"the Law has not constituted the Court as the regulator of the telecommunications industry; it has appointed the JCRA to that role and the JCRA has access to expert advice in discharging its responsibility of regulating the industry. The Court must in such circumstances give due weight to the views of the regulator in what is a technical and complex field."

38. However, the JCRA does accept the argument forwarded by JT where it cites the ERG report that: "*What is important …for regulatory certainty is that NRAs at the outset set out what are their objectives and aims and explain the reasoning for their choice of te*st." As a matter of best regulatory practice, predictability and proportionality are important principles of good regulation.

39. The methodological framework for assessing the allegation of margin squeeze and the JCRA's reasoning for choice of test has been explained to JT and JT has been engaged in the process over two years. However, it is the case that prior to the JCRA provisional decision JT would not have had formal sight of that choice of methodology. While the Licence Condition 34 has been contravened, and arguably JT was fully cognisant of the concerns raised by the JCRA and its wholesale customers through media statements and other communication from parties, the approach to remedies by the JCRA must be proportionate.

40. It is for this reason that neither a fine nor a retrospective remedy are recommended by JCRA officers having found that JT has contravened its licence condition. The remedy proposed is therefore essentially to correct for the margin squeeze identified going forward until replaced by a more comprehensive assessment using the usual price setting processes available to the JCRA under the Telecoms Law. In the view of JCRA officers this represents a proportionate response to the licence contravention.

DISMISSAL OF JT's DATA

41. In its Second Response JT repeats points made in previous submissions that the JCRA has failed to use JT's data.

42. The issue of what data was appropriate to rely on was discussed at the meeting of 15 March 2016 and the JCRA in its letter of 22 April 2016. Pages 3-5 of that letter specifically explain the JCRA approach to use of JT's own data and the limitations of that for its purposes. It also explained the rationale for the monthly usage levels, market share and average customer lifetime assumptions, which informed its findings. For completeness the relevant text is provided below:

<u>"Use of JT data</u>
JT in its response referred to the fact that it had provided SPC with its own internal margin squeeze model as well as providing the Authority with regulatory accounts submitted which should have been used in the analysis by the Authority.
The Authority's advisors did consider the internal margin squeeze model provided by JT. However, it considered that this model was based on a limited set of data and did not provide enough information to carry out the detailed analysis required.
The input data for the margin squeeze model used by SPC was taken from a number of sources; specifically the JT margin squeeze model (which itself used data from the JT separated accounts), SPC's "skill and judgement" and data received from other operators.

<u>Monthly usage assumption</u>

JT disagrees with the monthly usage assumption made by SPC when moving away from JT's costs. JT puts forward the argument that there is no entrant specific cost related to the need to provide unlimited broadband usage. JT considers that the appropriate question should be whether there is sufficient margin for an entrant to compete for customers who wish to have unlimited usage and therefore pay the JT Retail price with the additional overage revenue. JT considers that, in reality no entrant has needed to offer unlimited broadband with a high QOS[17] to compete with JT citing that Sure applies a fair usage policy and Newtel, in JT's opinion, does not purchase enough capacity to provide QOS. JT also drew attention to the fact that the UK usage is chosen from a report published in 2015 based on usage in December 2014. When JT set its prices, the publicly available UK usage statistic was 20GB/month (December 2013). In addition the UK data point is based on an average usage across all tariffs. JT considers that there is evidence that customers on lower speed tariffs use less data and therefore the average usage data point is not appropriate.

The average monthly usage assumption is material to the costs of JT as well as the entrant since it is used to dimension the backhaul circuits and IP Transit capacity needed and

[17] QOS – Quality of Service

therefore capacity costs. The average monthly usage of [✂]GB/month reported by JT which it suggests should have been used in the model, is in fact based on usage across all of JT's broadband product variants.

The Authority considers that the UK usage cited by JT would not be appropriate as an assumption in carrying out its assessment as this was taken at December 2013 which preceded the period of assessment relevant to this investigation (June 2014 to December 2015). As part of its data collection process, the JCRA was supplied with an average usage figure by a JT competitor that was in any event greater than the 58GB/month used. The vast majority of entrant customers are in any event lower speed customers (20Mb/s) rather than the higher variants. As data usage is increasing at a considerable rate, it is the case that even the 58GB/month is potentially conservative in setting a remedy to the margin squeeze as the entrant would need to plan for increasing usage in 2015.

<u>Market share assumption</u>

JT argues that adjustments related to market share are inappropriate on a conceptual basis. Other operators, according to JT, have lower off-island costs than JT. JT considers that Sure has economies of scale for off-islands wholesale costs when Sure's Guernsey business is taken into consideration. This results in a competitive situation which is not unique and where competitors are able to match or under-cut the costs faced by JT.
The model, however, is based on a hypothetical operator and not Sure (or any specific competitor in the Jersey broadband market). The market information from entrants is drawn on to reflect realistic market circumstances faced by JT's competitors and the REO test seeks to protect and promote competition rather than ensure margins for any given competitor to JT.

JT noted that, based on its REO approach, SPC assumed a 10% market share for the new entrant however the market shares published by CICRA[18] actually indicate a 13% market share for Newtel in 2013 and that by making a small adjustment to SPC's model to assume a 12.5% market share would lead to significant increase in the margin available.

However as noted above the assessment is not specific to one or other competitor in the broadband market. The fact is there are three broadband providers in the Jersey market, one with around 80% market share and two others with around 10%. Having carried out a sensitivity test of these assumptions, the Authority still finds that a margin squeeze has taken place and that this finding is robust against the assumptions made.

<u>Average Customer Lifetime</u>

JT observes a longer average customer lifetime than that used in the margin squeeze model with its average customer lifetime being greater than the current length of contract. In other margin squeeze decisions (e.g. Telefonica[19]) whilst competition authorities talk about entrants facing shorter lifetimes the authorities used the lifetimes of the dominant operator.

Information provided shows that average customer lifetime, for an entrant operator, was just short of 24 months. This appears to the Authority to provide a reasonable estimate of actual market conditions faced by JT competitors on which to base its assessment."

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[18] CICRA 15/39 – Telecommunications Statistics Marker Report 2013
[19] COMP/38.784, 4 July 2007, Wanadoo España vs. Telefónica

APPROPRIATE USE OF LICENCE CONDITION 34

43. The JT Second Response states that:

> *"There is an evident tension (and confusion) in the JCRA's approach between ex-post enforcement and ex-ante regulation. The obligations imposed on JT pursuant to condition 34 of its licence are clear; they are a manifestation of (ex-post) competition policy (i.e. a general prohibition against abuse of dominance), and therefore enforcement of the condition must be an enforcement of (ex-post) competition law principles, and cannot be the domain of ex-ante regulation. The JCRA has, however, incorrectly sought to treat enforcement of condition 34 as a matter of ex-ante regulation."*

And

> *"The JCRA's own stated view is that the market in Jersey is not mature. Furthermore, as set out above, the main aim in this particular case should be to not prevent competition (since that is what condition 34 requires), rather than to promote competition (a separate regulatory goal, which is not in line with its requirement under Article 7(2) of the Telecoms Law and not an obligation imposed on JT). The REO test is therefore inappropriate."*

44. Licence Condition 34 states that:

The Licensee shall:

(a) *not abuse any position of Significant Market Power and/or established position in any telecommunications market;*

(b) *not engage in any practice or enter into any arrangement that has the object or the likely effect of preventing, restricting or distorting competition in the establishment, operation and maintenance of Licensed Telecommunications Systems or the provision of Telecommunications Services; and*

(c) *comply with any direction issued by the JCRA for the purpose of preventing any market abuse or any practice or arrangement that has the object or effect of preventing, restricting or distorting competition in the establishment, operation and maintenance of Licensed Telecommunications Systems or the provision of Telecommunications Services.*

45. A margin squeeze has the likely effect of preventing, restricting or distorting competition in the establishment, operation and maintenance of the licensed broadband telecommunication services. The direction as recommended to remedy the finding of margin squeeze given JT's current prices is intended to ensure the margin squeeze which has the likely effect of preventing, restricting or distorting competition in the provision of broadband in Jersey. The enforcement of this licence condition which is placed on JT through the powers granted by the Telecoms Law to the JCRA which has duties under Article 7 is an exercise under the Telecoms Law.

46. It is not accepted there is an evident tension or confusion in the JCRA's approach between ex-post enforcement and ex-ante regulation. If JT is suggesting that any investigation of behaviour, including pricing that has already occurred in the past, can only be investigated under the Competition (Jersey) Law, 2005 and/or applying ex-post competition law principles this assumes

restrictions on the JCRA that supercede clear duties placed on the JCRA under the Telecoms Law. This is not an interpretation or position that is reasonable or consistent with law.

RESIDUAL ISSUES

47. JT has suggested it has not received a response to issues it raised about the specification of the margin squeeze test applied (i.e. at specific product level, rather than across all the products in the relevant market) and the static as opposed to dynamic approach to the period in question. The JCRA considers these were addressed on pages 5 and 6 of its provisional decision of 22 April 2016.

PART B

48. Part B discusses the conclusion the JCRA has come to based on the evidence and processes in carrying out this investigation.

49. The following key parameters inform the finding of a margin squeeze over the period assessed within the detailed model developed by SPC Network:

Router costs	A range between two assumptions is provided for: a. router is required to be installed at the customer's premises and the entrant receives a router compensation payment from JT Network b. router is already in situ at the customer's premises and therefore the entrant does not receive a subsidy payment from JT Network.
Competitor Market Share	10%
Average customer lifetime	24 months
Average usage	58 GB/month

50. Having carried out the assessment, there is strong evidence that JT was effecting a margin squeeze over the period June 2014 to December 2015. Specifically, based on the above parameters in the model and taking into account whether the entrant had to invest in a customer premises router and whether the operator could recover that expense, a margin squeeze has been identified in the range of **-28.2%**[20] to **-23.1%**[21] in respect of **JT Broadband Home** and a range of **-37.2%**[22] to -**31.7%**[23] in respect of **JT Broadband Complete**.

[20] CPE is provided but customer is not charged for the CPE

[21] No CPE is required to be provided

[22] CPE is provided but customer is not charged for the CPE

[23] No CPE is required to be provided

51. The ranges suggest the margin squeeze could not be depicted as trivial or simply a ‘technical’ breach.

52. In giving a direction, the Authority must be satisfied that the contravention is not trivial or that the licensee is not taking reasonable steps to comply with the condition and to remedy the effects of the contravention (Article 19(2G) of the Telecoms Law). The Authority finds that the contravention is not trivial and is not amenable to remedy. A direction to remedy this contravention going forward is therefore set out in Annex 1.

53. Article 19A of the Telecoms Law provides that the Authority may also impose a financial penalty where a licensee has contravened a condition contained in a licence. In order to impose a financial penalty, the Authority must be satisfied that the contravention is not trivial or that the licensee is not taking reasonable steps to comply with the condition and to remedy the effects of the contravention (Article 19A(13) of the Telecoms Law). As set out above, the Authority finds that the contravention is not trivial and is not amenable to remedy.

54. In deciding whether it would be appropriate to impose a financial penalty, and if so, the size of the penalty, the Authority has had regard to the following:

(a) The promotion period of 18 months has come to an end and there is no longer a margin squeeze caused by this pricing promotion;

(b) The approach to the assessment was based on assumptions of a reasonably efficient operator and this approach to assessing margin squeeze would not have been a framework JT had sight of when it announced its prices; and

(c) Introducing a price control model following a formal review, which will require JT to alter its pricing portfolio, is likely to address potential concerns in this area beyond the short term

55. In light of the points set out above, the Authority has determined that a financial penalty should not be imposed on JT in respect of this contravention.

56. Since the issue of the draft direction to JT in November 2015 new information informed the Authority’s decision on the appropriate margin squeeze test. Recent reviews on the number of routers deployed in JT’s market shows approximately [✂]% of the network is provided with Tilgin Fibre routers and approximately [✂]% are ADSL routers. As more customers are provided broadband services via JT’s fibre network this split will change. Therefore based on JT’s current wholesale and retail pricing and an estimate of JT’s current market share of 70% the Authority has identified that a margin squeeze will continue in the absence of any remedy[24]. As JT no longer offers its JT Broadband Complete product a remedy to address the historic margin squeeze on that product is not relevant going forward.

57. Following the ending of the contravention through the remedy obliged by the Direction, to ensure against future contraventions of this nature, the Authority intends to commence a wider

[24] This is based on JT’s current promotion of the first 3 months rental of a 24 month contract being offered at 50% discount. The above ranges are based on an entrant having a 15% market share.

industry review to inform a formal longer term broadband price control in both Jersey and Guernsey by the end of Q3 2016.

Yours sincerely

Michael Byrne
Chief Executive

23 June 2016 **By Order of the JCRA Board**

Annex 1

Decision

The Authority has concluded that JT (Jersey) Ltd. ("**JT**") has contravened Licence Condition 34 ("**LC34**") of its Class III Licence ("the **Licence**") issued under the Telecommunications (Jersey) Law 2002 ("the **Telecoms Law**").

Under Article 19 of the Telecoms Law the Authority issues the following direction to JT to require compliance with LC 34 by remedying the contravention identified as 'margin squeeze'.

The Authority directs JT to amend the combination of JT's wholesale and retail prices for the category of broadband products known as '**JT Broadband Home**' such that the existence of a margin squeeze shall be ended in two calendar months from the date of this decision.

The existence of a margin squeeze shall be ended by a combination of JT's wholesale and retail prices for its '**JT Broadband Home'** products such that when input into '**the Model'**, results in a margin that is not negative.

'The Model' is the excel spreadsheet previously provided to JT that will also be provided with this Decision set at predefined parameters (other than JT's wholesale and retail prices for the **JT Broadband Home** products). In particular the Model will have preset parameters in respect of market share of 70%, average customer lifetime of 24 months, monthly usage of 58 Gbps per month and setting for router costs as 'No CPE is required to be provided'.

The Authority will receive and agree any revised wholesale and retail broadband pricing before JT's notifies the price changes. The notification process will be carried out in accordance with JT's Licence Condition 33.

In giving this direction, the Authority must be satisfied that the contravention is not trivial or that the licensee is not taking reasonable steps to comply with the condition and to remedy the effects of the contravention (Article 19(2G) of the Telecoms Law). The Authority finds that the contravention is not trivial and is not amendable to remedy.

The Authority has determined that a financial penalty should not be imposed on JT in respect of this contravention.

23 June 2016 **By Order of the JCRA Board**